(1)

No. 91-1969

Supreme Court, U.S.
FILED
JUN 3 1992
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1991

ELMER FOBIAN and ELSE FOBIAN,

Cross Petitioners,

vs.

WESTERN FARM CREDIT BANK,

Cross Respondent.

Cross Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

CROSS PETITION FOR WRIT OF CERTIORARI

WAYNE B. HARBARGER, III
Attorney for Cross Petitioners
3445-A American River Drive
Sacramento, California 95864
(916) 485-5585

2081
Lutz Appellate Printers, inc. • NJ (908) 257-6850 • (800) 3 APPEAL • NY (212) 840-4640 • MA (617) 542-1114
DC (202) 783-7288 • PA (215) 925-6500 • USA (800) 5 APPEAL

QUESTION PRESENTED

If a Chapter 12 debtor elects treatment of a secured claim under 11 U.S.C. § 1225(a)(5)(C), is the debtor still liable for the undersecured portion of the claim?

LIST OF PARTIES

The parties to the proceeding below were the petitioners Elmer Fobian and Else Fobian and the respondents, Western Farm Credit bank, which is a federally chartered instrumentality of the United States and is part of the Federal Credit System.

TABLE OF CONTENTS

	Page
Question Presented	i
List of Parties	ii
Table of Contents	iii
Table of Citations	iii
Statement of Jurisdiction	2
Statutes Involved	2
Statement of the Case	3
Reasons for Granting the Writ	4
I. 11 U.S.C. § 1225(a)(5)(C) allows the debtor to downsize his farm and extinguish the obligation consonant therewith.	4
II. Since part of the problem of the family farmer was caused by the Farm Credit System, it must be responsible for part of the cure.	6
Conclusion	7

TABLE OF CITATIONS

Statutes Cited:

11 U.S.C. § 1225(a)(5)	2

Contents

Page

11 U.S.C. § 1225(a)(5)(A) 4

11 U.S.C. § 1225(a)(5)(C) .....i, 4, 6

11 U.S.C. § 1225(b) 3, 4, 5

28 U.S.C. § 1254(1) 2

Rule Cited:

Supreme Court Rule 12.3 2

APPENDIX

Appendix A — Judgment of the United States Court of Appeals for The Ninth Circuit Entered December 24, 1991 ..... 1a

Appendix B — Memorandum Opinion of the United States Bankruptcy Appellate Panel of The Ninth Circuit Filed August 16, 1990 ..... 12a

Appendix C — Memorandum Opinion and Order of the United States Bankruptcy Court for The Eastern District of California Filed August 7, 1989 ..... 25a

No.

In The

Supreme Court of the United States

October Term, 1991

ELMER FOBIAN and ELSE FOBIAN,

Cross Petitioners,

vs.

WESTERN FARM CREDIT BANK,

Cross Respondent.

Cross Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

CROSS PETITION FOR WRIT OF CERTIORARI

Elmer Fobian and Else Fobian, the petitioners herein, pray for a writ of certiorari to issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above captioned case on December 24, 1991. The petitioners pray for the writ of certiorari to issue only if the Court accepts the petition for writ of certiorari of Western Farm Credit Bank in the same case.

STATEMENT OF JURISDICTION

The date of the judgment by the Court of Appeals for the Ninth Circuit was December 24, 1991. The date of the denial of the petition for rehearing was February 4, 1992. The original petition by Western Farm Credit Bank for a writ of certiorari was received on May 5, 1992. The jurisdiction for the original petition for writ of certiorari is found in 28 U.S.C. § 1254(1). The jurisdiction for this cross petition for a writ of certiorari is invoked under the Rules of the Supreme Court, Rule 12.3.

STATUTES INVOLVED

At the hearing for the confirmation of the debtor's plan of reorganization, the debtors exercised their option under the Plan of Reorganization to surrender one parcel of land which was secured by a single deed of trust in favor of the Western Farm Credit Bank. The debtor believed that the surrender of the property securing the obligation to the holder of the obligation extinguished the balance of the obligation, if there be any. The statute upon which the debtors relied is 11 U.S.C. § 1225(a)(5) which reads in toto:

> (5) with respect to each allowed secured claim provided for by the plan —
>
> (A) the holder of such claim has accepted the plan;
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
> (ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on

> account of such claim is not less than the allowed amount of the claim; or
>
> (C) the debtor surrenders the property securing such claim to such holder; . . .

The Bank objected and asserted that they held an undersecured claim and that the unsecured portion was subject to 11 U.S.C. § 1225(b) which reads as follows:

> (b)(1) If the trustee or the holder of an allowed secured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan —
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

STATEMENT OF THE CASE

The case began as a single issue case and the issue was without precedent. The debtors owned a parcel of land used as a rice farm which had a valid encumbrance in favor of Western Farm Credit Bank. The debtor was unable to generate enough revenue from the parcel to pay the annual installment required by Western Farm

Credit Bank. The debtor proposed a Plan of Reorganization which would alternatively offer to reduce the obligation to Western Farm Credit Bank under 11 U.S.C. § 1225(a)(5)(A) or surrender the parcel to the Bank pursuant to 11 U.S.C. § 1225(a)(5)(C) in lieu of the obligation.

The Bank refused to consent to the reduction of the obligation and objected to the plan stating that they were entitled to payment of the undersecured portion of their claim pursuant to 11 U.S.C. § 1225(b).

The Bankruptcy Court ruled that the Bank had not established that they have an unsecured claim and confirmed the debtors' plan without amendment.

The Bank appealed to the Bankruptcy Appellate Panel of the Ninth Circuit which assumed an unsecured claim of the Bank and reversed the Bankruptcy Court. The debtor appealed to the United States Court of Appeals for the Ninth Circuit which affirmed the Bankruptcy Appellate Panel but denied the claim of the Bank for its attorney fees. As a result of the denial of the claim of attorney fees, the Bank filed a petition for writ of certiorari to this Court.

REASONS FOR GRANTING THE WRIT

I.

11 U.S.C. § 1225(a)(5)(C) ALLOWS THE DEBTOR TO DOWNSIZE HIS FARM AND EXTINGUISH THE OBLIGATION CONSONANT THEREWITH.

The debtors' position is clear. Congress created a set of alternatives to deal with the secured claims under Chapter 12. The debtor may (A) reach a compromise with the holder of the

secured claim as to the treatment of the claim; (B) the debtor may reduce the obligation on the collateral to the value of the property, retain the property used as collateral, pay the amount of the new obligation, and the holder of the secured claim will retain its lien; *or* (C) surrender the property securing the claim of the holder of the secured claim. If the treatment chosen by the debtor is (B), there usually exists an undersecured claim for the balance of the original obligation which is then treated under 11 U.S.C. § 1225(b).

In this case, the debtor chose alternative (C) and surrendered the property to the Bank by quitclaim deed. The debtor submits that its obligation to the Bank was extinguished at the time of the surrender of the property. The debtors' reasoning is that it no longer has the benefit of the collateral and should be free of the obligation which ran with the property.

Congress adopted Chapter 12 to allow the small farmer, such as Mr. and Mrs. Fobian, to reduce their obligations to an economically sound structure. For this reason, Congress gave the small farmer three alternatives to deal with the obligations on the land and farm equipment. The farmer could reach an accord with the lender, or it could reduce the obligation to the value of the collateral and retain the property, obligating itself to paying its disposable income for the following three years for the undersecured portion of the claim or it could surrender unprofitable and costly property and reduce its farming operation to become financially viable.

The argument of the Bank, that the small farmer can surrender its distressed property and still be liable for an undersecured portion of the debt against the property renders alternative (C) without meaning. Why would a farmer voluntarily surrender a property to a lender and still be liable for a sizeable portion of the original obligation? The farmer would always be

better off to choose alternative (B) if he cannot reach an accord with the holder of the secured claim on the property.

To give meaning to 11 U.S.C. § 1225(a)(5)(C), the court must allow a farmer to have the alternative to downsize his farming operation without increasing the debt load per producing asset. If the Bank's interpretation of alternative (C) is believed, the farmer would increase the financial burden on the remaining income-producing assets instead of creating a financially viable enterprise.

II.

SINCE PART OF THE PROBLEM OF THE FAMILY FARMER WAS CAUSED BY THE FARM CREDIT SYSTEM, IT MUST BE RESPONSIBLE FOR PART OF THE CURE.

An equitable argument in favor of the debtors' interpretation of 11 U.S.C § 1225(a)(5)(C) is that part of the reason for the oversecured status of the debtors' property is the poor lending practices of the farm lenders. If the farm lenders had not encouraged the rapid escalation of farm property values by supplying large, low interest loans on land with questionable abilities to earn revenue, the number of undersecured farm properties would be greatly reduced. Requiring the debtors to now pay the entire cost of the errors, caused only in part by the debtor, is inequitable. The governmental lenders, such as the one involved in this case, have thousands of employees working to determine the rates of return of all farming enterprises. The lenders of the Farm Credit System either did not care about the consequences of their lending practices or chose to disregard the facts of the small farms of America.

CONCLUSION

Congress enacted Chapter 12 to allow the small family farmer a chance to reorganize his farming enterprise into a financially viable business. One of the reorganization tools given to the small farmer is the ability to reduce the size of his farm and eliminate the unprofitable assets with their accompanying debt service. Without the ability to downsize, the small family farms will continue to remain in the same financial malaise and America will slowly lose an important component of its fabric.

Respectfully submitted,

WAYNE B. HARBARGER, III
Counsel of Record
LAW OFFICE OF
WAYNE B. HARBARGER, III
Attorney for Debtors/
Cross-Petitioners

APPENDIX A — JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT ENTERED DECEMBER 24, 1991

In re Elmer FOBIAN and Elsie Fobian, Debtors.

Elmer FOBIAN and Elsie Fobian, Appellants,

v.

WESTERN FARM CREDIT BANK, Appellee.

No. 90-16313.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Nov. 6, 1991.

Decided Dec. 24, 1991.

Wayne B. Harbarger, III, Sacramento, Cal., for appellants.

Gloria M. Greene, Tennant, Greene & Dutra, Sacramento, Cal., for appellee.

Appeal from the Ninth Circuit Bankruptcy Appellate Panel.

Before FLETCHER, WIGGINS and KOZINSKI, Circuit Judges.

FLETCHER, Circuit Judge:

Elmer and Elsie Fobian appeal from the decision of the Bankruptcy Appellate Panel ("BAP") reversing the bankruptcy court's confirmation of their chapter 12 plan. They argue that

the BAP erred in holding that the plan could not be confirmed because it did not meet the requirements of Section 1225 of the Bankruptcy Code.[1] The Bank argues for affirmance of the BAP's decision, and asks that we award it attorneys' fees and costs.

We affirm the BAP's decision, but award the Bank only costs on appeal.

BACKGROUND

The Fobians are solvent Chapter 12 debtors. They are current on all obligations except a loan from the Bank. The Bank holds a promissory note secured by 70.5 acres of land located in Glenn County, California and stock in the Federal Loan Bank Association of Northern California. After the Fobians filed their Chapter 12 petition, the Bank filed a Proof of Claim for $191,660.09. The Proof of Claim stated: "No security interest is held for this claim except Deed of Trust. Stock in FLBA of Northern California perfected pursuant to the Farm Credit Act of 1971." The Fobians made no objections to this Proof of Claim.

While the Fobians filed three plans, only the "First Amended Plan for Reorganization under Chapter 12" (the "Plan") was submitted for confirmation. The Bank filed objections to the plan and a confirmation hearing was held on June 27, 1989.

The plan provided for treatment of the Bank's claim as follows:

---

1. Unless otherwise stated, all references to "sections" refers to the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

Appendix A

The "Distressed Property" consists of approximately 70.5 acres of rice land in Glenn County undersecured by a promissory note and deed of trust to FLB [the Bank] in the approximate sum of $190,000 (including interest and penalties). The debtor also owes approximately 2 years real estate taxes to the County of Glenn on the property. The fair market value of the property is estimated by the Debtors to be $70,500.00. The Debtors would propose alternative treatments to the Secured Creditor.

The first alternative is a refinancing of the debt and write-off of balance over the new principal of $70,500. The new obligation would carry 9.0% interest for a term of 40 years with annual payments beginning 12/31/90.

The second alternative is that the Debtors will surrender the property pursuant to 11 USC 1225(a)(5)(C). Said surrender would be in full satisfaction of the amount allegedly due to the Secured Creditor.

Under either alternative there would be *no* undersecured obligation owed to the secured creditor, no deficiency judgments and no net disposable payments to be made through the trustee. The Secured Creditor may elect their [sic] choice of alternative until the date and time set for the hearing on the Plan. If the Secured Creditor has not chosen their alternative by the date and time set for hearing on confirmation of the Plan,

the Debtors may elect their choice of alternative.

The Bank did not elect either alternative. The Fobians then elected the second alternative, surrender of the property.

The Bank objected to confirmation of the Plan on the grounds that the plan did not take into consideration the unsecured portion of the Bank's claim, and did not comply with the requirements of Section 1225(a)(4). The Bankruptcy Court nonetheless confirmed the Plan in a Memorandum Opinion and Order Including Findings of Fact and Conclusions of Law filed on August 7, 1989.

The BAP reversed, holding that because the Plan did not meet the requirements of Section 1225, it could not be confirmed.

STANDARD OF REVIEW

We review the bankruptcy court's conclusions of law *de novo*. Findings of fact are upheld unless they are clearly erroneous. *Rubin v. West (In re Rubin)*, 875 F.2d 755, 758 (9th Cir. 1989).

DISCUSSION

Because the Plan fails to comply in several ways with Section 1225, the BAP was correct in reversing the bankruptcy court's confirmation. We now analyze in some detail the treatment of the Bank's claim by the bankruptcy court and the Plan.

1. Section 506

In confirming the plan, the bankruptcy court stated that at the time of confirmation the extent to which the bank was secured

was "uncertain." The bankruptcy court found that "it is clear that BANK has not yet become an unsecured creditor." Thus, the Bank could not invoke the protections Section 1225 provides for such claims. Looking in particular to description of the Bank's claim in the Plan itself, the BAP found that the bankruptcy court had erred in holding that the Bank held only a secured claim. The BAP was correct in this holding.

The BAP cited Section 506, which provides:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a). Section 506 required the bankruptcy court to determine whether the bank was both a secured and an unsecured creditor. Without doing so, the court could not apply the tests of Section 1225 to the plan.

II. Section 1225(a)(5)

The Fobians argue that the Bank has no unsecured claim under the plan as the Bank was offered the option of receiving

the property securing its claim in full satisfaction of that claim. In support of this argument, the Fobians invoke Section 1225(a)(5), which provides:

> (a) Except as provided in subsection (b), the court shall confirm a plan if—
>
> (5) with respect to each allowed secured claim provided for by the plan—
>
> (C) the debtor surrenders the property securing such claim to such holder
>
> . . .

11 U.S.C. § 1225(a)(5).

As the Fobians note, cases have acknowledged the "theoretical possibility" of a surrender of property in satisfaction of a secured debt; however, such cases have also recognized that such a solution is unworkable in practical terms. Absent the provision of some additional protection to the creditor, it is impossible to ensure that the creditor will receive the full amount to which it is entitled, and only that amount. Surrender of the property may satisfy the secured claim. However, if the value of the property is less than the amount of the claim, the creditor may retain an unsecured claim for the difference. If the value of the property surrendered turns out to exceed the amount of the claim, the secured creditor receives a surplus to which it is not entitled. Thus, the court in *In re Durr* rejected a plan which provided for the transfer of real property in satisfaction of a secured claim. The *Durr* court noted that a plan "proposing a payment with tangible property" must provide both for a "surplus of value" or for a "margin of

allowance" to ensure that the creditor received full value, and for a means of recapturing excess value the creditor might realize on disposition of the collateral. *In re Durr,* 78 B.R. 221, 225 (Bankr.D.S.D.1987). Because the plan at issue made no such provisions, it could not be confirmed. *Id., see also In re Indredland,* 77 B.R. 268, 274 (Bankr.D.Mont.1987) (approving plan which provided for transfer of property to secured creditor where the debtor had submitted a 5 year plan, and the creditor could return to the court for "redetermination of its claim" if it failed to realize the value of its claim on sale of the collateral).

In this case, the debtor's plan provides for neither the safeguard required by *Durr* nor the possibility of redetermination present in *Indreland.* While Section 1225(a)(5) would extinguish the Bank's claim to the extent it was secured, the unsecured portion would survive.

III. Section 1225(a)(4)

> Section 1225(a)(4) provides:
>
> (a) Except as provided in subsection (b), the court shall confirm a plan if—
>
> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title under such date . . .

11 U.S.C. § 1225(a)(4).

Here, all parties acknowledged that the debtor had substantial net worth. Thus, in a chapter 7 liquidation, the Bank would be paid in full. However, the Plan makes no provision for the unsecured portion of the Bank's claim. Therefore, the Plan does not meet the requirements of Section 1225(a)(4). The BAP was correct in reversing confirmation for this reason.

IV. Section 1225(b)

> Section 1225(b) provides:
>
> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the efffective date of the plan—
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

11 U.S.C. § 1225(b)(1).

Section 1225(b) does not provide an alternative to compliance with Section 1225(a); rather, each subsection must be satisfied

independently. *In re Willingham*, 83 B.R. 552, 553 (Bankr.S.D.Ill.1988).

Here, the Plan provides for no payment to the Bank in satisfaction of its unsecured claim. It also fails to provide for any portion of the Fobians' income to be applied to payments to the Bank. Thus, the Plan fails to meet the requirements of Section 1225(b). The BAP was correct in reversing confirmation on these grounds.

V. Award of Attorneys' Fees and Costs to the Bank

The Bank asks for an award of attorneys' fees and costs. It cites provisions in the promissory note and the deed of trust executed in relation to the loan which provide for the payment of fees and costs incurred in collection of amounts due or enforcement of rights.

A. Costs on Appeal

Bankruptcy Rule 8014 provides, in relevant part: "Except as otherwise provided by law, agreed to by the parties or ordered by the district court or bankruptcy appellate panel, costs shall be taxed against the losing party on appeal." Bankruptcy Rule 8014. Thus, we award the Bank its costs on its appeals before the BAP and before this court.

B. Attorneys' Fees at all levels; Costs in the Bankruptcy Court

Where a contract or statute provides for an award of attorneys' fees, a creditor may be entitled to such fees in bankruptcy proceedings. Such an award is governed by state law. *Collingwood Grain, Inc. v. Coast Trading Co. (In re Coast Trading*

Co.), 744 F.2d 686, 693 (9th Cir.1984); *Merced Production Credit Ass'n v. Sparkman (In re Sparkman),* 703 F.2d 1097, 1099 (9th Cir.1983).

However, where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorneys' fees will not be awarded absent bad faith or harassment by the losing party. *Coast Trading,* 744 F.2d at 693. (refusing to award fees where creditor brought a nondischargeability action); *Grove v. Fulwiler (In re Fulwiler),* 624 F.2d 908, 910 (9th Cir.1980) (refusing to award fees for creditor's action under Section 546); *see also Johnson v. Righetti (In re Johnson),* 756 F.2d 738, 741-42 (9th Cir. 1985) (because creditor's request for relief from the automatic stay pursuant to Section 362(d) was not an "action on the contract," debtor was not entitled to attorneys' fees for defense against the request).

Here, litigation involved solely issues of federal bankruptcy law: the Bank sought proper application of Sections 506 and 1225. This was not a traditional "action on the contract." [T]he question of the applicability of the bankruptcy laws to particular contracts is not a question of the enforceability of a contract but rather involves a unique, separate area of federal law." *Coast Trading,* 744 F.2d at 693. Thus, we decline to award the Bank attorneys' fees for its litigation of this case at all levels, and limit the award of costs to costs incurred on appeal.

AFFIRMED.

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 90-16313
BAP No. EC-89-1765

In re: ELMER FOBIAN and ELSIE FOBIAN,
Debtors,

ELMER FOBIAN and ELSIE FOBIAN,
Appellants,

v.

WESTERN FARM CREDIT BANK,
Appellee.

ORDER
(Filed Feb. 4, 1992)

Before: FLETCHER, WIGGINS, and KOZINSKI, Circuit Judges.

The petition for rehearing is denied.

APPENDIX B — MEMORANDUM OPINION OF THE UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT FILED AUGUST 16, 1990

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

BAP NO. EC
89-1765 ROAs

BK. NO.
288-07673-A-12

In re

ELMER FOBIAN, ELSE FOBIAN,

Debtors.

WESTERN FARM CREDIT BANK

Appellant,

v.

ELMER FOBIAN, ELSE FOBIAN,

Appellees.

Memorandum
(Filed Aug. 16, 1990)

Argued and Submitted on February 15, 1990
at Sacramento, California

Filed AUG 16 1990

Appendix B

Appeal from the United States Bankruptcy Court
for the Eastern District of California

Honorable Loren S. Dahl, Bankruptcy Judge, Presiding

Before: RUSSEL, OLLASON, and ASHLAND, Bankruptcy Judges.

Creditor Western Farm Credit Bank appeals from an order confirming the debtor's first amended plan of reorganization.[1] The plan did not meet the requirements of 11 U.S.C. Section 1225 because it failed to provide for Western Farm Credit Bank's unsecured claim. WE REVERSE and REMAND.

I.

FACTS

The debtors, Elmer and Else Fobian (Fobians) are solvent Chapter 12 debtors having a net worth of approximately $480,000. The debtors are current on all obligations except a certain loan No. 236077-2 to Western Farm Credit Bank (Western). Western holds a promissory note for the principal sum of $155,000 secured by 70.5 acres of rice land located in Glenn County, California and stock in the Federal Land Bank Association of Northern California. Western filed Proof of Claim for the amount owing, $186,864.18, on December 20, 198. Approximately $80,000 of

---

1. According to the Fobian's valuation, the fair market value of the land is $70,500. According to Western's valuation, the fair market value of the land is $110,000.

this is unsecured.[2] No objections were made to the Proof of Claim.

The Fobians filed three plans, but only the "First Amended Plan for Reorganization Under Chapter 12" was submitted for confirmation (the plan) and is the subject of this appeal. Western filed objections to the plan and a confirmation hearing was held on June 27, 1989. Western objected to it's treatment as the Class 5 Creditor on the real property loan No. 236078-0.

The First Amended Plan of Reorganization provided for Western's Class V claim as follows:

> The "Distressed Property" consists of approximately 70.5 acres of rice land in Glenn county *undersecured* by a promissory note and deed of trust to FLB in the approxiamte sum of $190,000 (including interest and penalties). The Debtor also owes approximately 2 years real estate taxes to the County of Glenn on the property. The fair market value of the property is estimated by the debtors to be $70,500.00. The debtors would propose alternative treatments to the secured creditor.

---

2. The court's "Memorandum Opinion and Order Including Findings of Fact and Conclusions of Law" was entered August 7, 1989. On August 17, 1989 Western Farm Credit Bank filed a Notice of Appeal "from the final Order of the Bankruptcy Court on the Creditor's Objections to Confirmation of the First Amended Plan as entered on August 7, 1989." The "Order of Confirmation of Debtor's Plan of Reorganization" was entered on August 25, 1989. It is clear that Western is appealing from the Order confirming the Debtor's plan.

Appendix B

> The first alternative is a refinancing of the debt and write-off over the new principal of $70,500. The new obligation would carry 9.0% interest for a term of 40 years with annual payments beginning 12/31/90.
>
> The second alternative is that the Debtors will surrender the property pursuant to 11 U.S.C. 1225(a)(5)(c). Said surrender would be in full satisfaction of the amount allegedly due to the Secured Creditor.
>
> Under either alternative there would be *no* under-secured obligation owed to the secured creditor, no deficiency judgments and no net disposable payments to be made through the trustee. The Secured Creditor may elect their choice of alternative until the date and time set for the hearing on the Plan. If the Secured Creditor has not chosen their alternative by the date and time set for hearing on confirmation of the Plan, the Debtors may elect their choice of alternative.

Appellants Excerpts, Exhibit T at 173.

Western objected to the plan on the grounds that it proposed to pay nothing on the unsecured portion of their claim. Western argued that under 11 U.S.C. Section 1225(a)(4) the court could confirm the Fobian's plan only if the value of the property received on their allowed unsecured claim was not less than the amount they would receive under a Chapter 7 liquidation. According to an updated financial statement of the debtors, the Fobians had a net worth of $481,000. Appellants Excerpts, Exhibit S at 121-122.

Since the debtor is solvent, Western would be paid in full on the loan under a Chapter 7 liquidation.

The court confirmed the plan in a Memorandum Opinion and Order Including Findings of Fact and Conclusions of Law filed on August 7, 1989. The court found that Western was not an unsecured creditor at the time of confirmation of the plan, although it may become an unsecured creditor at some time in the future. At such a time, Western would have to then pursue collecting any deficiency on the loan. The court disallowed a declaration by Western's appraiser as to the value of the property and refused to determine whether Western had unsecured status because the hearing was not noticed as a valuation hearing. The court found that it was not necessary for the plan to meet the requirements of Section 1225(a)(4) because Western was not an unsecured creditor.

II.

ISSUES

1. Whether the bankruptcy court erred in holding that Western Farm Credit Bank is not an unsecured creditor.

2. Whether the bankruptcy court erred in holding that 11 U.S.C. Section 1225 did not apply to confirmation of the plan.

III.

STANDARD OF REVIEW

Findings of fact are reviewed under a clearly erroneous standard and conclusions of law are reviewed *de novo*. *Ragsdale v. Haller*, 780 F.2d 794, 794 (9th Cir. 1986); Bankr. R. 8013.

Appendix B

IV.

DISCUSSION

A. WESTERN FARM CREDIT BANK HAS AN ALLOWED UNSECURED CLAIM

Western filed Proof of Claim for $186,864.18 on December 20, 1988. Section 502(a) provides:

> *Allowance of claims or interests.*
>
> (a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title objects.

No objections were made to Western's Proof of Claim, therefore it is deemed allowed.

Section 506(a) provides:

> *Determination of secured status.*
>
> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, . . .is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . *and is an unsecured claim to the extent that the value of such creditor's interest* . . . is less than the amount of such allowed claim. Such value shall be determined in light of

> the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or plan affecting such creditor's interest.

"Subsection (a) of this section separates an undersecured creditor's claim into two parts — he has a secured claim to the extent of the value of his collateral; he has an unsecured claim for the balance of his claim." 11 U.S.C. § 506(a), House Report (Reform Act of 1978) (Norton 1990).

Western contended in the trial court and reasserts here that its claim is secured for the value of the 70.5 acres of rice land, and unsecured for approximately $80,000. The bankruptcy court disagreed with Western.

> In this regard, the BANK's contention is incorrect. The BANK's proof of claim filed herein shows that the loan is evidenced by a promissory note which contains language referring to a deed of trust of the same date on the Glenn County property. In fact the proof of claim states that the obligation is not only secured by the deed of trust but also stock in FLBA of Northern California. These facts are not disputed by the debtors. At the present point in time, the BANK may be oversecured, undersecured or exactly secured. Which, is yet unknown. The court only knows from the evidence before it that BANK is secured but not to what extent.

Appellant's Excerpts, Exhibit J at 33.

Appendix B

The evidence before the court included a statement in the plan in which the debtor admits that Western is an undersecured creditor and that the fair market value of the property was $70,500. The court disallowed Western's evidence of a fair market value of $110,000, but under either figure Western has an unsecured claim of at least $80,000. Valuation of secured and unsecured claims at a hearing on confirmation of a plan is necessary for determining whether claims receive proper treatment in the proposed plan. *See In re Bremer*, 104 Bankr. 999 (Bankr. W.D. Mo. 1989); *In re Danelson*, 77 Bankr. 261 (Bankr. D. Mont. 1987).

Western's Proof of Claim states "[t]his claim is a general unsecured claim, except to the extent that the security interest, if any, described in paragraph 9 is sufficient to satisfy the claim." Paragraph 9 provides that "[n]o security interest is held for this claim except Deed of Trust recorded 6/4/81; capital stock of FLBA of Northern California created and perfected pursuant to the Farm Credit Act of 1971." Appellant's Excerpts, Exhibit W at 196. No evidence of the value of the FLBA stock was presented. Additionally, it is not clear whether the stock would be available for surrender under the Farm Credit Act. *See In re Greseth*, 78 Bankr. 936, 942-43 (D. Minn. 1987).

There was no dispute at the trial that the value of the land was less than the debt is secured. Mr. Harbarger, counsel for the Fobians so stated at trial during the following colloquy:

> THE COURT: I guess Miss Greene [Counsel for Western] is saying that as to the amount that the property is worth, fair market value is less than the total amount of the debt. They are unsecured as to that amount, right.

Is that what you're saying?

MISS GREENE: Yes.

THE COURT: What is your response to that?

MR. HARBARGER: If we did a (b)(5) program, that would be true. But if we are in here arguing about what the fair market value of the land, Judge, the balance will be unsecured. The balance will be unsecured. Then it's right. But that's not one of the options the Debtor is giving the creditor.

Either agree at this price or take it back. "I" or "I". We don't care. "I" is not one of the options. We don't want an unsecured creditor.

Appellant's Excerpts, Exhibit K at 51.

To hold that Western has only a secured claim ignores that plain language of Section 506(a). It is obvious that Western has an unsecured claim without determining to what extent. *See In re O'Farrell*, 74 Bankr. 421, 423 (Bankr. N.D. Fla. 1987) (Upon the court's valuation of property and the debtors' return of certain collateral to F.L.B. as proposed, any deficiency due F.L.B. shall be treated as an unsecured claim by the debtor's plan.)

We disagree with the bankruptcy court's conclusion that Western has only a secured claim and hold that as a matter of law, according to the plain language of Section 506(a), Western has both a secured and an unsecured claim. The issue of the extent of the unsecured claim is not before this Panel and we make no finding as such.

Appendix B

B. THE PLAN VIOLATES 11 U.S.C. SECTION 1225

Western alleges that it was improper for the bankruptcy court to confirm the Plan where it did not meet the requirements of Section 1225. Section 1225(a) sets forth the mandatory provisions for confirmation of the debtor's plan. Section 1225(a) provides in pertinent part:

> *Confirmation of plan.*
>
> (a) *Except as provided in subsection (b)*, the court shall confirm a plan if —
>
> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed *unsecured* claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such dated;
>
> (5) with respect to each allowed secured claim provided for by the plan —
>
> (A) the holder of such claim has accepted the plan;
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the

allowed amount of such claims; or

(C) the debtor surrenders the property securing such claim to such holder;

Western contends that the Plan does not meet the Section 1225(a)(4) "best interest" test. *See In re Nielsen*, 86 Bankr. 177 (Bankr. E.d. Mo. 1988) (surveying the interpretation and application of Section 1225(a)(4)). Under that subsection, the plan may only be confirmed if Western would receive not less under the plan than under a Chapter 7 liquidation. The evidence before the court was that the Fobians had a net worth of over $480,000, much of which were liquid assets.[3]

Western's debt would be paid in full upon a Chapter 7 liquidation but the plan does not provide for any payment of the unsecured debt. A plan cannot be confirmed where the debtors have sufficient assets yet propose to pay nothing to the unsecured creditor because it does not satisfy Section 1225(a)(4). *In re Novak*, 102 Bankr 22, 23 (Bankr. E.D.N.Y. 1989) "A farmer's plan cannot be confirmed if it fails to comply with 11 U.S.C. § 1225(a)(4)." *In re Nielsen*, 86 Bankr. 177, 178 (Bankr. E.D. Mo. 1988).

Western correctly contends that as the holder of an allowed secured and unsecured claim, the surrender of the property alone extinguished only the secured claim. The Fobians attempt to strip

---

3. The updated financial statement prepared by the Fobians and submitted to Western on March 1, 1988 and the testimony of Mr. Fobian at a 2004 examination on April 10, 1989 indicate that the Fobians had total assets of $875,450 and total liabilities of $394,000 for a net worth of $481,000. This evidence was before the bankruptcy court during the hearing on confirmation of the plan. Appellant's Excerpts, Exhibit S at 121-22.

Appendix B

Western of the protections afforded unsecured creditors by Section 1225(b).

However, Section 1225(a) is subject to subsection (b) which provides that:

> (b)(1) If the trustee or the holder of an allowed *unsecured* claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
>
> > (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
> >
> > (B) the plan provides that all of the debtor's projected income to be received in the three year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

Subsection (b) is separate from subsection (a) and sets forth an additional requirement that must be met if an unsecured creditor objects to confirmation of the plan. *In re Willingham*, 83 Bankr. 552 (Bankr. S.D.Ill. 1988). Neither requirement of Section 1225(b) was met by the plan. The property was less than the amount of Western's claim but there was no provision in the plan for any of the debtor's projected disposable income to be paid to Western.

"It is true Congress has exhibited a desire to keep the family farmer in operation, but *only* if the farmer complied with the

standards set forth in Chapter 12, and in particular, section 1225." *In re Nielsen*, 86 Bankr. at 178.

The Fobian's plan failed to meet the mandatory requirements of Section 1225, therefore, we REVERSE the confirmation of the Plan.

V.

CONCLUSION

We hold that as a matter of law Western Farm Credit Bank has both an allowed secured and unsecured claim under 11 U.S.C. Section 506(a). The requirements of Section 1225 were violated where the solvent Chapter 12 debtor's plan failed to provide for the unsecured claim that Western holds. Therefore, WE REVERSE the confirmation of the debtor's plan.

APPENDIX C — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF CALIFORNIA FILED AUGUST 7, 1989

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

No. 288-07673-A-12

Motion No.

Date Filed: May 16, 1989

Of: *Objection to Confirmation of First Amended Plan*

(Filed Aug. 7, 1989)

In re

ELMER FOBIAN and ELSE FOBIAN,

Debtor(s).

MEMORANDUM OPINION AND ORDER INCLUDING FINDINGS OF FACT AND CONCLUSIONS OF LAW

WESTERN FARM CREDIT BANK (BANK) filed objections on May 16, 1989, to confirmation of debtor's first amended plan (plan) in this Chapter 12 case. Hearings on the objections and on confirmation were held June 27, 1989. At the outset, the court advises counsel that post-hearing documents filed by the parties are not being considered.

The debtor's have two outstanding loans with BANK. The

Appendix C

BANK concedes that the first loan is fully secured by the "Home Ranch", and the payments are current. The second loan (Glenn) which has an approximate balance of $190,000.00 is secured by rice land in Glenn County and is delinquent. The BANK objects to the proposed treatment of this loan in debtor's plan contending *inter alia* that the plan fails to address the unsecured portion of Bank's claim under the Glenn loan. Bank contends that as to this loan it is secured for $110,000.00 and unsecured for $80,000.00. It also asserts other objections which will be discussed later herein but, first it is necessary to examine its contention that at present its Glenn loan is both secured and unsecured.

In this regard, the BANK's contention is incorrect. The BANK's proof of claim filed herein shows that the loan is evidenced by a promissory note which contains language referring to a deed of trust given to secure its payment and is secured by a deed of trust of the same date on the Glenn County property. In fact the proof of claim states that the obligation is not only secured by the deed of trust but also stock in FLBA of Northern California. These facts are not disputed by the debtors. At the present point in time, the BANK may be oversecured, undersecured or exactly secured. Which, is yet unknown. The court only knows from the evidence before it that BANK is secured but not to what extent. Nor is a determination of that fact before the court *sub judice*. The BANK is apparently trying to "bootstrap" its contention by filing a declaration of LOUIS VENTURINI, a BANK employee, wherein he expresses an opinion of value of the subject collateral. This hearing on BANK's objections were in connection with a confirmation hearing. It was not noticed as a valuation hearing and accordingly the VENTURINI declaration, which would be seriously questioned in any event because of his bias and lack of demonstrated qualifications, will be disregarded. The BANK did not timely accept debtor's "first

alternative" as set forth under Class 5 in the plan, hence the "second alternative" surrender of the property pursuant to 11 U.S.C. § 1225(a)(5)(C) becomes effective upon confirmation of the plan. Upon the debtors surrender of the Glenn property to BANK pursuant to 11 U.S.C. § 1225(a)(5)(C), steps can be taken by BANK as stated in 5 Collier on Bankruptcy, 15th Ed. ¶1225.02, page 1225-9, 10, "If there is a deficiency remaining after the disposition of the surrendered collateral, the creditor would be entitled to an allowed unsecured claim for that amount. The debtor and creditor could also otherwise agree or the creditor could accept the collateral in full satisfaction of its claim."

From the foregoing, it is clear that BANK has not yet become an unsecured creditor. It may never. But if it does at some later time, it may then pursue its rights as such.

The BANK also objects contending that the plan does not comply with Bankruptcy Code Section 1225(a)(4). This is the "best interests" test to be invoked for the protection of unsecured creditors. Because BANK is not presently an unsecured creditor, it has no standing to make this objection.

Further, the Bank urges that the plan has not been proposed in good faith as required by Section 1225(a)(3). The court has read the 2004 examination of ELMER FOBIAN taken April 10, 1989, but finds nothing therein which would support a finding that the plan was not proposed in good faith. In short, admissible evidence is lacking to support this objection.

The last objection recites that the required 25-day notice of the confirmation hearing was not given. At the most the notice was insufficient by three days, depending on the applicability of FRCP 6(e). This does not appear to be an objection *per se* and

at least as to this objecting creditor, it apparently did not affect it, for its counsel presented its objections fully and timely.

This opinion shall constitute findings of fact and conclusions of law. The BANK's objections to confirmation are denied. Counsel for the debtors will submit an order of confirmation.

IT IS SO ORDERED.

DATED: AUG 7 1989

/s/Loren S. Dahl
Chief Judge, United States
Bankruptcy Court

I certify that on AUG 7 1989, a copy of the foregoing Memorandum Opinion and Order was mailed to the following:

GLORIA M. GREENE, ESQ.
Tennant, Parshall, Read & Dutra
350 University Avenue, Suite 110
Sacramento, CA 95825
(Attys for Creditor, Western Farm Credit Bank)

WAYNE B. HARBARGER, III, ESQ.
725 30th Street, Suite 212
Sacramento, CA 95816
(Atty for Debtors)

/s/ Nancy Williams

Appendix C

Wayne B. Harbarger III
LAW OFFICE OF
WAYNE B. HARBARGER, III
725 30th Street, Suite 212
Sacramento, CA 95816
Telephone: (916) 446-6660
Telecopier: (916) 446-3329

Attorney for Debtor
ELMER FOBIAN and ELSE FOBIAN

Appendix C

IN THE UNITED STATES BANKRUPTCY COURT
IN AND FOR THE EASTERN DISTRICT
OF CALIFORNIA

Case No. 288-07673-A-12

In Re:

ELMER FOBIAN and ELSE FOBIAN

Debtor

ORDER OF CONFIRMATION OF DEBTOR'S PLAN OF REORGANIZATION

(Filed Aug. 25, 1989)

On June 27, 1989 at 2:00 p.m. in Department A, the Debtor's Plan of Reorganization was heard by the Honorable Loren Dahl. After considering the Debtor's Plan of Reorganization, written objections thereto, oral arguments by all interested counsel and the Trustee, the Court makes the following Order Confirming and Amending the Debtor's Plan of Reorganization:

1. Debtors herein are qualified as a Family Farmer to file a Chapter 12 within the meaning of 11 USC section 101 (17);

2. Debtors have complied with all notice requirements and has timely filed its Plan of Reorganization;

3. The Debtors Plan was proposed in good faith and complies with the provisions of Chapter 12 as and with all other applicable statutes and Rules of Court;

Appendix C

4. DISCHARGE OF DEBTOR:

Upon payment of the claims to the Class 1 creditors and payment of $2000.00 to the Chapter 12 trustee and execution of a quit claim deed to the Class 5 creditor, the Debtor shall be discharged.

5. PRIOR CLAIMS BARRED:

Since no adversary actions were filed within the statutory period, all claims which were listed and treated in the Debtor's plan of reorganization are forever barred from further action against the Debtor save those creditors and claims classified as class 3 creditors which may exercise their contractual rights in the event of default if they do not conflict with applicable state law.

6. CLASS 1 CLAIMS:

The Debtors shall pay to the class 1 creditors their billings upon presentation and without further Order of this Court.

7. CLASS 2 CREDITOR:

The Debtor's counsel shall transmit a check held in trust for the trustee in the amount of $2,000.00 to the trustee upon receipt of an endorsed Order of Confirmation.

8. CLASS 3 & 4 CREDITOR:

The Debtor shall maintain the obligation in a current condition.

Appendix C

9. CLASS 5 CREDITOR:

The Debtor shall execute a Quit Claim Deed to the real property to the lienholder, Western Farm Credit Bank. The property as tendered shall constitute full satisfaction of the indebtedness owed to Class 5 Creditor on the real property loan no. 236078-0.

10. UNSECURED CREDITORS:

The Debtors have no unsecured creditors.

11. RETENTION OF JURISDICTION:

The Court shall retain jurisdiction to determine:

(a) allowance or disallowance of claims;

(b) determination of professional compensation;

(c) such other matters as the Debtor may bring before the Court.

12. EFFECTIVE DATE OF THE PLAN:

The effective date of the Plan shall be 30 days after the execution of the ORDER OF CONFIRMATION of the Plan.

DATED: AUG 25 1989

LOREN S. DAHL
LOREN S. DAHL
U.S. BANKRUPTCY JUDGE